Worksession

Agenda Item #	4
Meeting Date	29 May 2007
Prepared By	Sara Anne Daines HCD Director
Approved By	Barbara B. Matthews City Manager

Discussion Item	Continued discussion of Proposed Revisions to Rent Stabilization
Background	The Council will meet with Kenneth Baar to continue its discussion of the proposed recodification of *City Code Chapter 6.20 Rent Stabilization*. The primary focus of the May 29 presentation will be on the proposed fair rate of return rent increase standard. Additional discussions are planned throughout the months of June and July with the Council provided an opportunity to consider the adoption of any amendments to the City Code in late July, prior to the August recess. A public hearing on the proposed amendments has been tentatively scheduled for July 9.
Policy	"To complete recodification of Chapter 6.20 Rent Stabilization." *Affordable Housing Policy and Action Plan (July 2005)*
Fiscal Impact	N/A
Attachments	Baar Memorandum Fair Return Standard
Recommendation	To develop support for recommendations for the revision of the current Rent Stabilization Ordinance which will preserve the community's existing affordable rental housing stock while addressing concerns regarding the complexity of the existing law and its administration.
Special Consideration	

Working Draft
May 25, 2007

To: Takoma Park City Council

From: Ken Baar

Date: May 25, 2007

Re: Fair Return Standard

A draft of is enclosed of a new fair return section of the Rent Stabilization ordinance replacing the current fair return (hardship) portion of the ordinance,

The proposed revisions would continue the underlying fair return concept, under which fair return (fair net operating income) is defined as base period net operating income adjusted by an inflation factor.

However, the proposed revisions also introduce four major changes.

1) A termination of separate passthroughs for capital improvements. Instead., capital improvements would be considered as amortized expenses within the fair net operating income standard.

2) Mortgage payments would not be considered. This change is based on the view that allowable rent increases should not be dependant on the apartment owner's particular financing arrangements. Instead, the rent increase standard should be "neutral" in regard to financing arrangements.

3) A fixed interest would be allowed on capital expenses that are amortized. This interest rate would be determined by a published prevailing interest on fixed rate mortgages at the time the rent increase application is filed.

4) The landlord would have the option of selecting the year 2000 as the base year.

These proposed revisions do not consider the procedural aspects of the fair return rent adjustment process. Also, the proposed revisions do not consider the very specific facets of the regulations. This draft may be seen as a conceptual introduction to the changes that are proposed rather than a finely tuned product. Its purpose is to set forth the conceptual direction of the proposed changes.

Landlords and tenants have not been consulted prior to the preparation of this proposal. It is essential that their feedback be elicited, especially in light of the long and somewhat complex history of the ordinance.

Working Draft
May 25, 2007

Section 6.20.0__. Rent Increases Pursuant to Fair Return Petitions

A. Purpose. The Purpose of this Section Insure that Landlords have a right to charge rents which will provide a "Fair Return".

B. **Definition of Fair Return**. "Fair Return" is defined as "Base Year" "Net Operating Income" adjusted by __% of the percentage increase in the Consumer Price Index (CPI) since the Base Year.[1]

C. "**Net Operating Income**" = "Gross Income" - "Operating Expenses"

D. **Gross Income**

1. The annual scheduled rental income for the property based on the rents that the landlord was permitted to charge at the time of the application,

2. minus a vacancy allowance based on the actual vacancy rate for the property during the two prior years, subject to a limitation on the vacancy rate of __%, unless the landlord can show by a preponderance of the evidence that a higher rate would be reasonable,

E. **Operating Expenses**

Operating Expenses shall include all Reasonable operating and maintenance expenses including but not limited to:

1. Utilities paid by the landlord, unless these costs are passed through to the tenants;

2. Administrative expenses, such as advertising, legal fees, accounting fees, etc;

3. Management fees, whether performed by the landlord or a property management firm.

   It shall be presumed that management fees increased by the percentage increase in the CPI between the base year and the current year, unless the level of managment services either increased or decreased during this period.

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[1] For example, if the base year net operating income is $100,000 and the CPI has increased by __% since the Base Year, a Fair Net Operating Income would be $___,___ ($100,000 * (1 + (.__ * pct. increase in CPI).

4. Payroll;

5. The amortized cost of capital improvements. An interest allowance shall be allowed on the cost of amortized capital expenses; the allowance shall be interest rate on the cost of the capital replacement equal to the "average rate" for thirty year fixed rate mortgages plus one percent. The "average rate" shall be the rate Freddie Mac last published in its weekly Primary Mortgage Market Survey (PMMS) as of the date of the initial submission of the petition.

6. Self-labor costs computed in accordance with the regulations adopted pursuant to this Section;

7. Property taxes;

8. Licenses, government fees and other assessments;

9. Insurance costs

When an expense amount for a particular year is not a reasonable projection of ongoing or future expenditures for that item, said expense shall be averaged with other expense levels for other years or amortized or adjusted by the CPI or may otherwise be adjusted, in order to establish an expense amount for that item which most reasonably serves the objectives of obtaining a reasonable comparison of base year and current year expenses.

F. **Exclusions from Operating Expenses**.

Operating expenses shall **not** include:

1. Payments made for mortgage expenses, either principal or interest;
2. Fines from noncompliance with Housing Code violations or COLTA Orders;
3. Damages paid to tenants as ordered by COLTA or the courts;
4. Depreciation;
5. Late fees or service penalties imposed by utility companies, lenders or other entities providing goods or services to the landlord or the rental facility;
6. Membership fees in organizations established to influence legislation and regulations;

7. Contributions to lobbying efforts;
8. Contributions for legal fees in the prosecution of class-action cases;
9. Political contributions for candidates for office;
10. Maintenance expenses for which the landlord has been reimbursed by any security deposit, insurance settlement, judgment for damages, agreed-upon payments or any other method;
11. Any expense for which the tenant has lawfully paid directly;
12. Attorney' s fees charged for services connected with counseling or litigation related to actions brought by the City under City regulations or Title 6, Housing, of this Code, as amended. This provision shall apply unless the landlord has prevailed in such an action brought by the City;
13. Additional, expenses incurred as a result of unreasonably deferred maintenance.[2]
14. Any expense incurred in conjunction with the purchase, sale, or financing of the rental facility, including, but not limited to, loan fees, payments to real estate agents or brokers, appraisals, legal fees, accounting fees, etc.
15. Any other expense that does not benefit the rental facility, such as, but not limited to, the cost of or forming a corporation, partnership or other entity or buying out a stockholder or partner of the landlord.

G. Selection of Base Year

The applicant may select one of the following as the base year:

1. 1979, unless the property contains four or fewer rental units.
2. 1987, if the property contains four or fewer rental units.
3. 1990
4. 2000

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[2] For example, if the replacement of a roof was unreasonably delayed, the replacement cost of the roof would still be allowed as an expense. However, if damage to the building occurred as a result of delay in the roof replacement, such as damage to the plaster, that expense would not be allowed.

However, if a prior rent increase has been obtained pursuant to a fair net operating income standard, the base year shall be the year that was designated as the current year in the prior application.

H. Computation of Base Year Net Operating Income

At the landlord's option base year net operating income shall be calculated to equal 40% of the gross income of the property in 1990.

However, iIf a prior rent increase has been obtained pursuant to a fair net operating income standard, base year fair net operating income shall be the net operating income that was deemed as a fair net operating income pursuant to the prior hearing.

I. Base Year CPI

The Base Year CPI for each of the following Base Years shall be as follows:

1. 1979 - _____

2. 1987 - _____

3. 2000 - _____

4. Other calender years - the annual average CPI _________ for that year.

5. Other fiscal years - the CPI published in December of the twelve month period including in the fiscal year.

J. Adjustment of Base Year Net Operating Income

It may be determined that the Base Year Net Operating Income yielded other than a fair return, in which case the base year Net Operating Income may be adjusted.

In order to adjust the Base Year Net Operating Income, the Commission must make at least one of the following findings:

1. Base Year Net Operating Income was abnormally low due to one of the following factors:

   a. The landlord made substantial capital improvements which were not reflected in the base year rents and the landlord did not obtain a rent adjustment for these capital improvements,

b. Substantial repairs were made due to exceptional circumstances,

c. Other expenses were unreasonably high, notwithstanding prudent business practice

2. Base Year Rents did not reflect market transaction(s), due to one or more of the following types of circumstances:

a. There was a special relationship between the landlord and tenant that resulting in abnormally low rent charges (such as a family relationship or a close friendship).

b. The rents had not been increased for five years preceding the base year.

c. The tenant lawfully assumed maintenance responsibilities in exchange for low rent increases or not rent increases.

d. other special circumstances which establish that the rent was not set as the result of an arms-length transaction.

K. Current Year

The current year shall either be the calendar year or the fiscal year (July 1-June 30) immediately preceding the date that the application is filed.

L. Current Year CPI

If the current year is a calender year, the current year CPI shall the annual average CPI for that year.

If the current year is a fiscal year, the current year CPI shall be the CPI published in the twelve month period including the fiscal year.

M. Submission of Income and Expense Information for Years Preceding the Current Year

The applicant shall be required to submit income and expense information for the two years prior to the current year.

N. Scope of Commission Authority in Setting Rents

Notwithstanding any other provision of this ordinance or regulations instituted pursuant to this ordinance, the Commission shall be authorized to take into account any factors which it is required to consider by law and grant whatever rent increase is constitutionally required in order to yield a fair return.